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ABSTRACT

This report presents the results of a U.S. General Accounting Office (GAO) review of lender and Department of Education controls over the accuracy of lender-submitted quarterly billings under the Federal Family Education Loan Program, also known as the guaranteed student loan program. It reports that both lenders and the Department of Education demonstrate lacking or inadequate controls for ensuring accurate and reliable data. While there is no evidence showing material overbillings, the GAO report does indicate that an operating environment exists with a significant potential for errors. Major problems in lenders' systems and data control environments are reported in the following areas: (1) ineffective controls over the integrity of the software programs and access to data used to prepare quarterly billings; (2) inadequate controls over the validity, accuracy, and completeness of processed data; (3) inadequate documentation to support summary totals reported on quarterly billings; and (4) inadequate or no written policies and procedures for preparing the quarterly billings. Further, both the Department of Education and guaranty agencies do not conduct sufficiently comprehensive on-site reviews or edit checks to determine whether lenders' systems and data generate accurate quarterly billings. Appendices provide the scope and methodology of the report and comments from the Department of Education. (GLR)

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United States General Accounting Office

GAO

Report to the Secretary of Education

September 1993

ED 362 135

FINANCIAL MANAGEMENT

Education's Student Loan Program Controls Over Lenders Need Improvement

HE026 743

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GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-202873

September 9, 1993

The Honorable Richard W. Riley
The Secretary of Education

Dear Mr. Secretary:

This report presents the results of our review of lender[1] and Department of Education controls over the accuracy of lender-submitted quarterly billings under the Federal Family Education Loan Program (FFELP), commonly known as the guaranteed student loan program. Based on these billings, Education paid lenders about $1.9 billion in fiscal year 1992 for interest subsidies on about $63 billion in reported student loans outstanding as of September 30, 1992, and expects to pay about $2 billion in fiscal year 1993. Education also relied on this quarterly billing information for reporting program financial activity and managing program operations.

This review was part of our financial audit of FFELP's September 30, 1992, Principal Financial Statements. Our opinion on those statements, the program's internal control structure, and its compliance with laws and regulations, along with Education's overview of the financial entity and other supplemental information prescribed by the Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576), was issued separately.[2]

Results in Brief

Controls at lenders and Education for ensuring that accurate and reliable data were reported to Education in lenders' quarterly billings were often inadequate or lacking. Thus, Education relied on unverified summary billing data to pay quarterly interest subsidies to lenders, report program financial activity, and manage program operations. While we did not find material overbillings, this operating environment posed a significant potential for errors. For example, we found inaccuracies or inconsistencies in the quarterly billings submitted by 27 of the 46 lenders we reviewed. Among the major problems in lenders' systems and data control environments were

[1]For the purposes of this report, the term "lender" refers to any eligible bank, savings and loan, loan servicing organization, or other entity making or holding federally guaranteed student loans.

[2]Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Year 1992 (GAO/AIMD-93-04, June 30, 1993).

- ineffective controls over the integrity of the software programs and access to data used to prepare quarterly billings;
- inadequate controls over the validity, accuracy, and completeness of processed data;
- inadequate documentation to support summary totals reported on quarterly billings; and
- inadequate or no written policies and procedures for preparing the quarterly billings.

Furthermore, Education and guaranty agencies did not conduct sufficient comprehensive on-site reviews to determine whether lenders' systems and data generated accurate quarterly billings. Nor did Education's automated edit checks or tests of the reasonableness of information lenders reported provide assurance that data reported in the quarterly billings were reasonable.

Background

FFELP was initially established under Title IV[3] of the Higher Education Act of 1965, as amended. Its primary purpose is to increase post-secondary educational opportunities for eligible students. Education's costs for the program are funded, for the most part, by appropriations, collections on defaulted loans, and loan origination fees from lenders. Interest subsidies paid to lenders and default claims paid to guaranty agencies represent the two largest program expenses incurred and reported in the FFELP Principal Financial Statements. Education reported that since fiscal year 1966, it has guaranteed approximately $142 billion in student loans and paid about $35 billion in interest subsidies and about $19 billion in default payments.

Participants in the program include the Department of Education, student and parent borrowers, schools, originating lenders, secondary markets, and guaranty agencies. Overall responsibility for FFELP resides in Education's Office of Postsecondary Education (OPE). Its duties include establishing program policies and procedures, administering the program on a day-to-day basis, operating FFELP information systems, and overseeing the activities of the various program participants. OPE also accounts for FFELP operations and reports those results to Education's CFO. The CFO is responsible for maintaining Education's accounting records, preparing the FFELP annual financial statements, and reporting the financial results of all Education programs to the Office of Management and Budget and Treasury.

[3]Title IV refers to the portion of the Higher Education Act that established the student financial aid programs at institutions of higher education and vocational schools. Federal Family Education Loan, Federal Pell Grant, and Federal Perkins Loan Programs are currently included in Title IV.

Borrowers, usually students, initiate the loan process by providing eligibility information to the schools and applying for loans from any of the about 8,000 participating lending institutions. The lenders then forward the loan applications to the appropriate guaranty agencies for approval. If the guaranty agencies approve the loans, the lenders disburse the loan amounts. Lenders holding federally guaranteed student loans are ultimately responsible for servicing those loans in accordance with applicable laws and regulations. Lenders, however, may contract with a loan servicing agency or other party to actually perform these functions.

Education pays participating lenders interest benefits and special allowances in accordance with the Higher Education Act, as amended, and FFELP regulations. These payments are based on information reported to Education on the Lender's Interest and Special Allowance Request and Report (quarterly billings). In general, Education makes interest payments on outstanding loans while students are in school and during grace and deferment periods after students leave school. Additionally, Education may make special allowance payments throughout the period in which the loans are outstanding.[4] Special allowance payments are adjusted quarterly as Treasury bill rates change.

About 50 guaranty agencies participate in FFELP. These guaranty agencies perform various tasks, including (1) issuing guarantees to lenders on qualifying loans, (2) overseeing lenders' management of insured loans, including verifying that lenders properly serviced and attempted to collect loans before paying default claims, and (3) paying lenders for losses caused by default, death, disability, or bankruptcy. Most guaranty agencies generally receive 100-percent reimbursement from Education on the default claims paid to lenders.

Objective, Scope, and Methodology

Our objective was to determine whether controls were in place at lenders and Education to ensure that quarterly billing information submitted to and used by Education is accurate and reliable. To accomplish this objective, we selected 46 lenders for review from about 8,000 lenders participating in the program as of June 30, 1991. The lenders selected held over 50 percent of total outstanding guaranteed student loans of about $63 billion as of September 30, 1992. We reviewed 14 of the lenders selected, and the Department of Education's Office of the Inspector General (OIG) contracted with Price Waterhouse to review the remaining

[4]As used in this report, the term "interest subsidies" includes special allowances.

32 lenders. We determined the scope of work to be performed on all 46 reviews.

The work was performed at the Department of Education headquarters in Washington, D.C., and at the major student loan servicing facilities of the 46 lenders selected for review between March 1992 and December 1992 in accordance with generally accepted government auditing standards. Appendix I presents a more detailed description of our scope and methodology.

The Department of Education provided written comments on a draft of this report. These comments are discussed later in this report and are included in appendix II.

Some Lenders Had Inadequate Controls Over Reported Quarterly Billing Information

Of the 46 lenders reviewed, 32 had not instituted adequate controls to ensure that the information reported in their quarterly billings was correct. According to Education's regulations, lenders are entitled to receive and retain interest subsidy payments if they submit accurate and adequately supported quarterly billing information on federally guaranteed student loans held during a reporting quarter. We identified ineffective controls over the integrity of software programs and access to data used to prepare quarterly billings; inadequate controls over the validity, accuracy, and completeness of processed data; inadequate documentation to support summary totals reported in the lenders' quarterly billings; and inadequate documentation of policies and procedures for preparing quarterly billings. As a result of these control weaknesses, Education had little assurance that lenders' quarterly billing information, which is used as the basis for interest subsidy payments, was not materially misstated.

Weaknesses in Lender EDP General Controls

Significant weaknesses in electronic data processing (EDP) general controls existed at three of the four lenders at which we reviewed these controls. Effective EDP general controls are intended to provide reasonable assurance that (1) computer resources are protected against unauthorized physical and logical access, loss, or impairment, (2) entity software used to process financial and management information is tested and approved, (3) computerized security and other controls over systems software are not compromised, (4) job responsibilities are properly segregated to prevent individuals from circumventing established EDP controls, and (5) impact of interruption of computer operations is minimized and such operations may be resumed promptly if interrupted. The adequacy of these

general controls is a significant factor in determining the effectiveness of software application controls and certain manual control techniques. Without effective EDP general controls, lenders' software application controls may be circumvented or modified, thereby reducing the reliability of data reported in quarterly billings.

At two of the four lenders whose EDP controls we reviewed, controls over modifications to software did not provide reasonable assurance that only authorized and properly tested programs were used to process and access quarterly billing data. In these instances, assigned programmers had access to programs after they had been tested and approved but before they were implemented. Because of this, programmers could, either inadvertently or deliberately, change previously approved programs.

Also, at three of the four lenders, controls over data access did not provide reasonable assurance that access was appropriately restricted. For example, these three lenders did not have procedures for management's periodic review of reports of user and programming staff access to computer systems to ensure that access was authorized and modified, as necessary, to reflect changes in job responsibilities and terminations of employment. Because of these weaknesses, Education could not be assured that these lenders' data were being properly processed or that the resulting reports used in preparing the quarterly billings were reliable.

Lender Controls Did Not Always Reasonably Ensure the Validity, Accuracy, or Completeness of Processed Data

Education's regulations require lenders to use certain calculation methods to derive average daily loan balances reported on their quarterly billings. Additionally, Education requires lenders to include prior period adjustments in their quarterly billings to correct previous quarterly billing errors or to update information previously submitted to Education. Common prior period adjustments reported on the quarterly billings include billing adjustments for interest subsidies as a result of student status changes and failure to follow Education's prescribed origination, default claim prevention, and collection procedures. Adjustments are also required to correct lender errors in the allocation of borrower loan payments between principal and interest.

Of the 46 lenders reviewed, 22 calculated and reported average daily balances improperly on at least one of two quarterly billings tested. Lender errors included omitted or improperly calculated billing adjustments, late or improper borrower payment postings, improper inclusion or exclusion of outstanding loan balances in the average daily balance calculation, and

use of improper average daily balance calculation methods. As a result, Education used incorrect reported average daily balances to calculate amounts due to lenders in these cases.

Examples of lender errors in calculating and reporting average daily balances were as follows:

- 4 of the lenders reviewed omitted prior period adjustments from their billings because their automated systems were unable to track these adjustments and the lenders had not developed alternative methods to do so;
- 3 of the lenders improperly calculated prior period adjustments because they did not have systems or methods to capture information related to prior quarterly billing errors and updates or to ensure its accuracy; and
- 1 lender improperly calculated average daily balances reported on its quarterly billings because its loan accounting system delayed posting borrower payments for a day after their receipt and in certain instances posted payments as of the date they were processed instead of the actual payment dates.

These problems are not new. In an August 1988 report,[5] we identified similar errors that lenders made in their billings to Education for interest subsidy payments. These errors included miscalculating loan balances and interest subsidies due, maintaining inadequate documentation to support their quarterly billings, and billing Education for interest after borrowers began repaying their loans. In that report, we recommended that the Congress amend the Higher Education Act to authorize the Secretary of Education to assess lenders an interest penalty for billing errors made. As of June 1993, such an amendment had not been enacted.

Lenders Did Not Always Maintain Adequate Supporting Documentation

Education's regulations require lenders participating in FFELP to maintain current, complete, and accurate records for loans on which interest subsidies are paid. Additionally, Education may require refunds of interest subsidies paid if lenders are unable to provide support for the amounts reported to Education. However, 16 of the 46 lenders reviewed lacked documentation to support information reported on at least one of two quarterly billings that we tested. For example, 5 of the 46 lenders could not provide loan-level detail to support the average daily balances reported in the interest or special allowance sections of their quarterly billings.

[5]Guaranteed Student Loans: Lenders' Interest Billings Often Result in Overpayments (GAO/HRD-88-72, August 31, 1988).

Interest subsidies paid to these 5 lenders, based on unsupported average daily balances, totalled about $13 million and $11 million for the quarters ended September 30, 1991, and March 31, 1992, respectively.

We also found that 10 of the 46 lenders reviewed lacked appropriate documentation to support certain information reported in the portfolio analysis sections of their quarterly billings. In these instances, one or more of the amounts reported were estimated or unsupported. These sections provide Education with summary information on (1) the changes in the ending principal balance of student loans from the beginning to the end of each quarter and (2) the ending principal balance by loan status and days delinquent. Education relied on information reported in the portfolio analysis sections to assess the reasonableness of its estimate of principal outstanding loan balances used in deriving certain amounts reported in the program's financial statements and to report lender portfolio data in its Guaranteed Student Loan Program Data Book, a report on the program's activity. Because this information may be unreliable, Education could not be assured that it received the financial information needed to effectively report on and manage FFELP.

Lenders Did Not Always Maintain Written Policies and Procedures

Of 46 lenders reviewed, 4 did not have written policies and procedures for preparing their quarterly billings. At two other lenders, these policies and procedures were incomplete or outdated. While Education's regulations did not require lenders to maintain written policies and procedures, this common business practice is critical for ensuring that loans are serviced in a consistent manner and that data are accurately reported.

One instance we identified illustrates the importance of written policies and procedures. A lender was unable to report on its student loan portfolio after the January 1992 resignation of the key individual responsible for the portfolio's administration partly because it did not have any written policies or procedures for preparing quarterly billings. At the time of our review—June 1992—this lender had not submitted a quarterly billing to Education for any periods subsequent to the quarter ended December 31, 1991, and was unable to answer any questions relating to its previously submitted billings. Furthermore, because current lender management did not have sufficient knowledge of the guaranteed student loan program and its requirements, virtually all loan servicing activities had ceased. Therefore, borrowers may not have been repaying their loans and may be difficult to locate in the future. This lender's reported student loan portfolio totalled $871,407 as of December 31, 1991.

Education Paid Lenders Interest Subsidies Without Adequate Assurance That Amounts Were Valid

Education did not have adequate controls and procedures for ensuring that information reported in the lenders' quarterly billings was accurate and that it had not overpaid interest subsidies. Guaranty agency and Education reviews of lender operations and Education's automated edits and tests of the reasonableness of lender-submitted information were not comprehensive enough to give Education assurance that the information reported in the lenders' quarterly billings was accurate. In addition, during Education's transition to a new student loan processing contractor, Education made duplicate and sometimes triplicate interest subsidy payments to certain lenders because Education and its contractor—which began processing student loans at the end of fiscal year 1992—did not establish adequate controls over the conversion of certain automated systems. These overpayments were subsequently recovered.

On-Site Lender Reviews Were Not Adequate to Assess Accuracy of Quarterly Billings

Education's primary means for determining the reliability of lenders' quarterly billings are reviews of such billings performed by guaranty agencies and/or Education's oversight staff. However, these reviews did not provide sufficient assurance that the data reported were accurate.

FFELP regulations require guaranty agencies to conduct comprehensive, biennial, on-site program reviews of each participating lender whose loan volume guaranteed by the agency in the preceding year equaled or exceeded 2 percent of the total of all loans guaranteed in that year by the agency or was one of the 10 largest among lenders whose loans were guaranteed in that year by that agency. In March 1993, we reported[6] that Education did not have adequate controls and procedures to ensure that it received the financial information needed from lenders to effectively manage FFELP. Specifically, we stated that guaranty agency reviews of lenders were limited in scope, which in turn limited their value in detecting problems with the quarterly billings submitted to Education. For example, guaranty agencies focused exclusively on their own guarantees at various lenders. Since most lenders held loans covered by several guaranty agencies, these reviews could not provide Education with assurance that any individual lender's quarterly billings were accurate.

Like the guaranty agency reviews, Education's lender oversight staff reviews did not provide assurance that information reported in the quarterly billings was accurate. Education relied on its regional oversight staff to judgmentally select the lenders to be reviewed generally based on

[6]Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement (GAO/AFMD-93-20, March 16, 1993).

(1) their knowledge of current financial activities and trends among lenders in their regional markets, (2) public and congressional complaints, (3) guaranty agency recommendations, (4) regulatory agency referrals, and (5) available staff resources. The staff performed about 500 lender reviews—mostly at lenders holding small guaranteed loan portfolios—during fiscal year 1992. Traditionally, the staff has concentrated its efforts on smaller lenders because the guaranty agencies were required to review the larger lenders. While this approach appears reasonable, Education's methodology for selecting lenders does not ensure that all lenders have an equal chance of being selected for review; therefore, the methodology could not be used to determine if overall quarterly billings were accurate.

Additionally, Education did not use standardized test procedures at all lenders reviewed. Our evaluation of the reviews performed by oversight staff showed that Education generally did not test the systems lenders used in preparing their quarterly billings or test the information reported in the portfolio analysis sections of their quarterly billings. We identified 28 different automated systems being used to accumulate data reported in their quarterly billings at the 46 lenders reviewed. Education's policies and procedures, however, did not require its lender oversight staff to review any of these systems. Also, because oversight staff generally did not statistically select sample items, test results could only be used as an indicator of individual errors and not to determine whether the summary totals reported in the quarterly billings were materially misstated.

The Higher Education Amendments of 1992 required, beginning in 1993, annual compliance audits of lenders conducted by qualified independent organizations or persons. These audits could be used by Education to determine the reliability of lenders' quarterly billings and identify lenders for supplemental review. In addition, Education officials told us that Education plans to improve its monitoring of lenders by hiring more financial managers; providing better training, including training in statistical sampling, for its program reviewers; and implementing a new loan data system, known as the National Student Loan Data System, which will include reasonability tests of lenders' quarterly billings, by mid-1994.

In our March report, we recommended that the Secretary of Education direct the Assistant Secretary of Postsecondary Education to require that lenders annually give Education an independent public accountant's positive attestation on the claims for payment submitted to the federal government and the basis for such attestation, including an opinion on the

adequacy of internal controls over such claims. This recommendation, if implemented, should improve Education's oversight of lenders by providing assurance that quarterly lender billings are accurate. Education agreed with our recommendation in principle and stated it will work with its OIG to ensure that these billings are tested and other steps are taken in this area to strengthen future audits of lenders.

Education's Internal Testing to Ensure the Reliability of Quarterly Billing Information Was Limited

Education's internal tests of lender reported information did not provide assurance that the data reported in the quarterly billings were reasonable. In fiscal year 1989, Education implemented automated edits and reasonability tests to determine the reasonableness of amounts reported on lenders' quarterly billings. The automated edits were intended to verify that information on lenders' quarterly billings adhered to certain established program regulations and reporting criteria. If these billings failed to meet the programmed edits, Education's system generated either a rejection notice to the lender requiring it to correct and resubmit its billing or an edit message describing what internal action should be taken to resolve the situation. Payment of interest subsidies to lenders was generally not affected or delayed unless the quarterly billing was rejected and returned to the lender for correction. The reasonability tests compared amounts reported on the lenders' quarterly billings to other lender data reported in current or past billings and checked for certain logical relationships among those data. If a lender's quarterly billing failed to meet any of the reasonability tests, Education's system generated a reasonability failure notice requesting that the lender review its records and submit any necessary adjustments.

In those instances where a lender's quarterly billing failed to meet certain edit checks or reasonability tests but was not rejected, Education did not have procedures for ensuring adequate follow-up with lenders to ensure that they either reported proper adjustments or otherwise addressed and resolved the issues raised in Education's notification letter. For example, if an edit check determined that an amount a lender reported as an interest billing adjustment was identical in two separate billing quarters, Education's procedures required that its loan processing contractor contact the lender and verify that a duplicate interest adjustment had not been reported. Because this situation indicated only the possibility of an error in the lender's quarterly billing, the edit was overridden and the billing processed without further investigation or follow-up if Education's contractor was unable to contact the lender in 2 business days. Additionally, lenders receiving a reasonability failure notice were not

required to respond to Education if they determined that no adjustments were necessary after reviewing their records.

Education Made Some Erroneous Multiple Payments to Lenders

Education made duplicate and triplicate interest subsidy payments totaling about $190,000 to 39 lenders during its transition to a new student loan processing contractor at the end of fiscal year 1992. These erroneous payments were made because Education and its new contractor did not have adequate controls to detect duplicate payments during the processing of lenders' quarterly billings. Additionally, Education had not developed standard procedures for the conversion of major automated systems. As a result, the systems Education's new and prior contractors used were not operated on a parallel basis during the conversion period to ensure that payments and other data were properly processed.

According to Education's new contractor, the system it used for processing interest subsidy payments to lenders included a programmed edit check that prevented duplicate payments if established processing procedures were followed. However, during October 1992, inexperienced contractor personnel incorrectly posted several lenders' billings to the system more than once, thus circumventing the established processing procedures. Furthermore, the contractor did not institute control procedures when implementing the system to ensure that all system edits were functioning as intended. As a result, duplicate and triplicate interest subsidy payments were not prevented or detected by controls in place at Education or its new contractor.

One lender notified Education of the erroneous multiple payments in October 1992. In December 1992, after Education had determined the cause and the extent of these overpayments, it notified lenders by letter of overpayments made and requested appropriate refunds. As of June 1993, Education had collected all of the overpayments from lenders.

Education's contractor has initiated actions to address some of its processing control weaknesses, including (1) correcting the error in the system edit for preventing duplicate payments, (2) designing detail reports of payments which specifically identify duplicate payments, and (3) providing additional training and operating procedures to personnel responsible for processing the quarterly billings.

Conclusions

Weak controls at lenders and Education over the accuracy of information reported on the lenders' quarterly billings create the potential for significant errors. Implementing our previous recommendation that Education require lenders to annually submit to Education an independent public accountant's positive attestation on the lenders' claims for interest subsidy payments and an opinion on the adequacy of the lenders' internal controls over such claims—which could be accomplished through the annual compliance audits required under the Higher Education Amendments of 1992—would help address these weaknesses. Concurrently, we believe that Education must restructure the information and control systems it uses in its dealings with lenders and demand validation of program payments.

Recommendations

We recommend that the Secretary of Education direct the Assistant Secretary of Postsecondary Education and the Chief Financial Officer to coordinate efforts to develop a comprehensive strategy for determining the accuracy of information reported on lenders' quarterly billings which would include

- developing objective criteria for selecting and reviewing lenders participating in FFELP and
- annually performing mandatory review procedures at selected lenders which, at a minimum, would include reviewing results of annual compliance audits—required by the Higher Education Amendments of 1992—and other audits of lenders and following up on identified weaknesses to determine if appropriate corrective actions have been taken.

We further recommend that the Secretary of Education direct the Assistant Secretary of Postsecondary Education and the Chief Financial Officer to coordinate efforts to

- monitor and follow up with lenders whose quarterly billings fail to meet Education's internal automated edit checks and reasonability tests and
- develop and implement procedures for converting major automated systems, including a requirement that parallel systems be run for an appropriate period of time, to ensure that new systems are properly processing program data.

Agency Comments and Our Evaluation

In general, the Department agreed with our findings and recommendations but stated that the absence of material overbillings in our report suggests the existence of other effective management controls. However, the objective of our work was not to specifically identify overbillings. Our objective was to determine whether controls were in place at lenders and Education to ensure that quarterly billings submitted to and used by Education were accurate and reliable. Our findings, as acknowledged by Education in commenting on a draft of this report, indicate that there remains a potential for significant errors as a result of the control weaknesses identified.

Regarding our recommendation to develop a comprehensive strategy for determining the accuracy of lenders' quarterly billings, the Department concurred and stated that it is currently revising its strategy for monitoring the accuracy of lender billings to assure that annual audits, now required for all lenders, are effectively used and coordinated with reviews of lenders done by Education and guaranty agencies. However, Education commented that it intends to maintain its flexibility to adjust its reviews, based on professional judgment, in order to focus on current issues and complaints. While flexibility is important, following up on material weaknesses in internal controls over lenders' claims identified during the annual compliance audits to determine if appropriate corrective actions were taken is critical for determining the accuracy of lenders' quarterly billings.

Education generally agreed with our recommendation that it coordinate OPE and CFO efforts to oversee lenders whose billings have failed edit checks. Education commented that it is considering requiring the lenders' auditors to review and resolve the edit reports sent to the lenders during the lenders' annual audits and that it will continue to monitor lender billings during program reviews and audits. However, Education stated that it does not reject those billings that appear illogical—but are correct in certain circumstances—because this may subject the Department to significant penalties. We are not suggesting that all billings that fail edit checks be rejected and not paid, but rather that (1) the causes of edit failures be examined further and that (2) Education monitor and follow-up with lenders whose quarterly billings fail to meet its internal automated edit and reasonability checks.

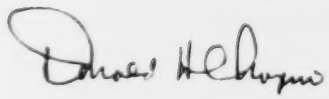
Education also agreed with our recommendation that it develop procedures for major system conversions and stated that it intends to perform complete parallel testing on future conversions to the extent that

the conversion schedule permits. However, Education should always schedule time to perform complete parallel testing when developing major system conversion plans. Additionally, Education stated that while the duplicate payments discussed in this report was a serious issue, the amounts involved were insignificant. We emphasize that although dollar errors material to overall program costs were not found, control weaknesses existed at Education that could have resulted in significant duplicate payments.

This report contains recommendations to you. As you know, the head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations. You should send the statement to the Senate Committee on Governmental Affairs and the House Committee on Government Operations within 60 days of the date of this letter and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made over 60 days after the date of this letter.

We are sending copies of this report to the Director of the Office of Management and Budget; the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs and the House Committee on Government Operations; and other interested parties. Copies will be made available to others upon request. This report was prepared under the direction of George Stalcup, Associate Director, who can be reached at (202) 512-2850. Other major contributors to this report are listed in appendix III.

Sincerely yours,



Donald H. Chapin
Assistant Comptroller General

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Abbreviations

CFO	Chief Financial Officer
EDP	electronic data processing
FFELP	Federal Family Education Loan Program
OIG	Office of the Inspector General
OPE	Office of Postsecondary Education

Scope and Methodology

The 46 lenders selected for review were randomly chosen using a probability proportionate to size method. Under this method, lenders with larger outstanding guaranteed student loan portfolios had a greater chance of being selected than those with smaller portfolios. We reviewed 14 of the lenders selected, and the Department of Education's OIG contracted with Price Waterhouse to review the remaining 32 lenders. We determined the scope of work to be performed on all 46 reviews. In addition, we reviewed and tested the work Price Waterhouse performed under its contract with Education to ensure that Price Waterhouse complied with generally accepted government auditing standards and to determine whether the evidence in its working papers supported its review conclusions.

At the selected lenders, we tested the accuracy of amounts reported on their September 30, 1991, billings to Education by tracing amounts reported to supporting documentation. We also compared these amounts to balances reported in the lenders' general ledgers. For these same lenders, we performed similar tests at either December 31, 1991, or March 31, 1992. Additionally, we compared amounts reported for a sample of 1,200 student loan balances to supporting documentation that lenders maintained and tested these balances through confirmations sent to the borrowers.

To evaluate the selected lenders' controls over information submitted to Education on the quarterly billings, we reviewed and documented lenders' procedures for accumulating and reporting such information. We also interviewed lender personnel at the various locations visited. Additionally, we reviewed previous reports on the lenders' systems or loan administration under FFELP that were issued by guaranty agencies, Education's program divisions, Education's OIG, and independent public accountants. At the four lenders in our sample with the largest outstanding guaranteed student loan balances (about 40 percent of total outstanding loan balance), we evaluated EDP general controls over guaranteed student loan systems.

At Education, we identified the controls and procedures in place to ensure it received the information needed from lenders to effectively manage FFELP. We interviewed officials at Education and reviewed appropriate financial reports and other supporting documentation. We also reviewed our previous reports on FFELP as well as those by Education's OIG.

Comments From the Department of Education

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

THE ASSISTANT SECRETARY

JUL 22 1993

Donald H. Chapin
Assistant Comptroller General
Accounting and Financial Management Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Chapin:

The Secretary has asked me to respond to your request for comments on the General Accounting Office (GAO) draft report, "Financial Audit: Federal Family Education Loan Program's Internal Controls Over Lender-Submitted Data Need Improvement," GAO/AIMD 93-33, which was transmitted to the Department of Education (ED) on July 9, 1993.

Thank you for the opportunity to review the GAO draft report. We commend your staff for the efficient and professional manner in which they conducted this review.

The enclosed response to the draft report was developed jointly with the Chief Financial Officer. If you have any questions, please contact Molly Hockman, Acting Director, Accounting and Financial Management Service, on (202) 708-6234.

Sincerely,

David A. Longanecker

Enclosure

400 MARYLAND AVE., SW WASHINGTON, DC 20202-5100

General Accounting Office (GAO) Draft Report, "Financial Audit: Federal Family Education Loan Program's Internal Controls Over Lender-Submitted Data Need Improvement", GAO/AIMD-93-33, Dated July 9, 1993

OVERVIEW:

In general, ED concurs with the GAO findings and recommendations to address certain control weaknesses in the payment of lender billings. However, the absence of material overbillings found by GAO in its audit of 46 lenders holding over 50 percent of total outstanding loans suggests the existence of other effective management controls, such as:

1) Employee selection and training procedures at the larger lenders that reduce the probability of errors or fraudulent bills;

2) Frequent audits performed on behalf of bond holders, secondary markets, and servicing clients, which raise larger lenders' awareness of the need for data accuracy and compliance with program regulations;

3) Recent improvements in ED and guarantor oversight of lender activities.

Nevertheless, we agree that there remains a potential for errors as a result of the control weaknesses identified by the GAO. Following are ED's specific responses to the recommendations:

RECOMMENDATION 1:

Recommend that the Secretary of Education direct the Assistant Secretary of Postsecondary Education and the Chief Financial Officer to coordinate efforts to develop a comprehensive strategy for determining the accuracy of information reported on lenders' quarterly billings which would include annually

-- *developing objective criteria for selecting and reviewing lenders participating in Federal Family Education Loan Program (FFELP) and;*

-- *performing mandatory review procedures at these lenders which, at a minimum, would include reviewing results of annual compliance audits--required by the Higher Education Amendments of 1992--and other audits of lenders and following up on identified weaknesses to determine if appropriate corrective actions have been taken.*

ED RESPONSE:

ED agrees with the recommendation. ED is currently revising its strategy for monitoring the accuracy of lender billings to assure that annual audits now required of all lenders are effectively used and coordinated with ED and guarantor reviews of lenders. For example,

ED is considering requiring guarantors to focus their onsite lender reviews on entities with characteristics that suggest a probability of errors, such as, a significant change in volume or defaults during the past year, high cohort default rates, significant errors in default claims, or consumer complaints. ED would then concentrate its reviews on major originators and holders of loans, special purpose reviews requested by ED management, and lenders, large or small, for which significant complaints have been received.

The regions also receive a Lender Review Candidates Report generated by the lender billing system. This report provides objective information such as lender size, type, billing rejections, reasonability test failures, growth, and other information to identify possible candidates for review. However, the Guarantor and Lender Oversight Staff (GLOS) Director and regional offices must be allowed to exercise their professional judgement and maintain the flexibility to adjust their review schedules/plans to permit their small staffs to focus on current issues and complaints.

To assist us in developing additional selection criteria for lenders, we would appreciate more information from the GAO auditors on the specific errors found at the lenders reviewed and the degree to which they occurred.

RECOMMENDATION 2:

Recommend that the Secretary of Education direct the Assistant Secretary of Postsecondary Education and the Chief Financial Officer to coordinate efforts to

-- *monitor and follow up with lenders whose quarterly billings fail to meet Education's internal automated edit checks and reasonability tests and*

-- *develop and implement procedures for converting major automated systems, including a requirement that parallel systems be run for an appropriate period of time, to ensure that new systems are properly processing program data.*

ED RESPONSE:

ED generally agrees with the recommendation. ED has developed two kinds of automated edit checks for the lender billing process. The first kind detects data conditions that can clearly be classified as errors. In these cases, the billing forms are not processed and lenders are not paid until the errors are corrected. The second kind detects data conditions that appear illogical, but are correct in certain circumstances. Thus, if ED were to reject all such billings, ED could be required to pay significant amounts of penalty interest. Therefore, ED does not reject these billings, but instead notifies the lender that an error may have been made and asks the lender to correct any errors through adjustments to subsequent billings.

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ED relies on lenders' knowledge that they may be subjected to an audit or program review to provide an incentive to correct errors of which they are notified. Summary information on the results of the edit and reasonability tests for each lender is provided to regional review staff on an annual report. As a further check, ED is considering requiring the lender's auditor to review and resolve the edit reports sent to the lender during the lender's annual audit. The fact that GAO found no material overbillings seems to indicate that this system works reasonably well with respect to amounts billed to the government. ED will continue to monitor lender billings during program reviews and audits.

ED agrees with GAO that procedures should exist for major system conversions. However, we believe these procedures should be specific to each individual system. ED routinely prepares conversion plans that include provisions for parallel testing when reprocuring major automated systems, and did in this case. In addition, requirements were present in both the old contract and the new contract for the contractors to support parallel testing of critical financial systems. However, in some cases the length and complexity of the Federal procurement cycle does not result in adequate conversion time to perform optimum parallel testing. In this case, although we had planned for a nine-month conversion period, it was necessary to shorten the conversion to five months. As a result, only limited parallel testing was actually performed during conversion. Automated files were used for parallel testing rather than key-entering documents in both systems. In future conversions we intend to perform complete parallel testing to the extent that the conversion schedule permits.

Although ED views the occurrence of duplicate payments as a very serious issue, it should be noted that the amount of erroneous payments equalled less than one one-hundredth percent of total annual lender payments.

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